

REPORT OF EXAMINATION
OF THE
AMERICAN STERLING INSURANCE COMPANY
AS OF
DECEMBER 31, 2004

Participating State
and Zone:

California

Filed October 12, 2005

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
COMPANY HISTORY	2
MANAGEMENT AND CONTROL:	3
Management Agreements	5
TERRITORY AND PLAN OF OPERATION	5
REINSURANCE:	6
Assumed.....	6
Ceded	6
FINANCIAL STATEMENTS:	7
Statement of Financial Condition as of December 31, 2004	8
Underwriting and Investment Exhibit for the Year Ended December 31, 2004.....	9
Reconciliation of Surplus as Regards Policyholders from December 31, 2001 through December 31, 2004.....	10
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	11
Losses and Loss Adjustment Expenses	11
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	11
Current Report of Examination.....	11
Previous Report of Examination	11
ACKNOWLEDGEMENT	12

Los Angeles, California
August 19, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

AMERICAN STERLING INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 27422 Portola Parkway, Suite 110, Foothill Ranch, California 92610.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; and sales and advertising.

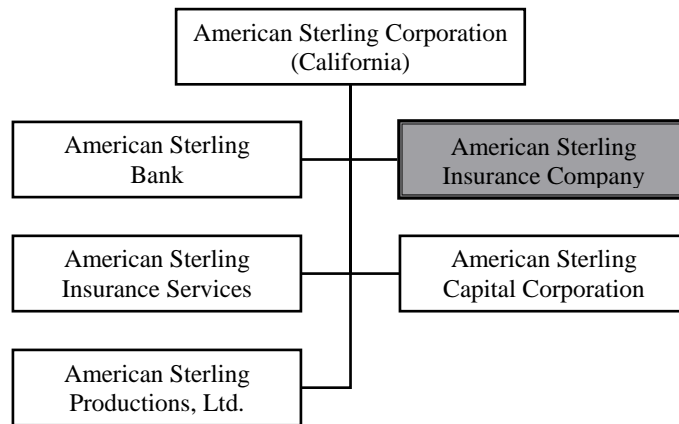
COMPANY HISTORY

The Company was incorporated in California on September 4, 1979, as Universal Security Insurance Company. On December 26, 1984, the Company's name was changed to Camino Insurance Company. In November 1986 American Sterling Corporation (ASC) purchased the Company and gave the Company its current name.

During 2004, the Company paid a \$400,000 cash dividend to ASC.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of American Sterling Corporation (ASC). The following abridged organizational chart, which is limited to the Company's parent along with its active subsidiary companies, depicts the Company's relationship within the holding company system: (all ownership is 100%)



Management of the Company is vested in a six-member board of directors elected annually. A listing of the members of the board and principal officers serving as of December 31, 2004 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael D. Thompson Overland Park, Kansas	Chairman American Sterling Corporation
Lawrence K. Dodge Dana Point, California	Founding Chairman and Chief Executive Officer American Sterling Corporation
John W. Meara Kansas City, Missouri	Partner Meara, King, & Company
Ron Dearden Laguna Niguel, California	Treasurer, Assistant Secretary, and Chief Financial Officer American Sterling Corporation
Kristina J. Dodge Dana Point, California	Stockholder American Sterling Productions, Ltd.
Stephen C. Hull Lee's Summit, Missouri	President American Sterling Bank

Principal Officers

<u>Name</u>	<u>Title</u>
Michael D. Thompson	President
Lawrence K. Dodge	Chief Executive Officer
Ron Dearden	Treasurer, Assistant Secretary, and Chief Financial Officer
Kwan H. Lee	Chief Operating Officer
Stephen B. Winnings	Chief Information Officer and Senior Vice President, Information Systems
Wendi D. Hall	Senior Vice President
Janice K. Thrower	Secretary

Management Agreements

Management Agreement: On January 1, 1995, the Company entered into a management agreement with its parent, ASC, to act as its exclusive management consultant. Under this agreement, the Company reimburses ASC for the actual costs incurred on its behalf. Costs that cannot be determined by Company are allocated by mutual agreement.

Consolidated Federal Income Tax Liability Allocation Agreement: The Company and its affiliates are part of a consolidated federal income tax agreement with ASC. Allocation of taxes are based upon separate return calculations, with inter-company tax balances settled when taxes are due. If the subsidiaries have any items of credit or loss, their share of the reduction of tax liability shall be returned to them within 30 days of the filing of the consolidated return.

Sub-lease Agreement: On July 1, 2004, the Company entered into a sub-lease agreement with American Sterling Bank. Pursuant to the agreement, the Company will lease a general office area located at 27442 Portola Parkway, Suite 150 Foothill Ranch, California 92610 for a monthly lease of \$4,585 for the first 30 months and \$4,809 until the end of the lease.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to transact multiple lines of property and casualty insurance business. The following is a listing of the states in which the Company is licensed:

California	Ohio
Florida	Oklahoma
Indiana	Oregon
Kansas	Pennsylvania
Kentucky	Washington
Missouri	Wisconsin
Nebraska	

In 2004, the Company wrote \$259,788 in direct premiums. Of the direct premiums written, 100% were written in California.

The principal lines of business written are personal lines, including private passenger auto liability, auto physical damage, and homeowners multiple peril, which amounted to approximately 100% of the Company's total premiums written. The Company writes business through approximately 250 brokerage firms and independent agencies and maintains branch offices in Irvine and Laguna Hills, California.

The Company historically wrote property coverage obtained through financial institutions, much of which was force placed. In 1997, 81% of American Sterling Insurance Agency, Inc. (ASIA), an affiliated agency, was sold; the remaining 19% was sold in 1998. All business obtained by the Company through ASIA was placed into runoff. The Company then began writing personal lines business. The Company's entrance into personal lines business proved more difficult than anticipated. At the beginning of 2001, the Company concluded that it needed to cease writing personal lines. Currently, the Company will continue to write a limited amount of personal lines business in California while the Company develops other programs.

REINSURANCE

Assumed

The Company had a 100% quota-share assumption fronting arrangement with Vesta Fire Insurance Company, an Alabama insurer, with no maximum limits. This covered any property business produced by American Sterling Insurance Agency, Inc., a formerly affiliated agency, in states where the Company was not an admitted insurer. This contract was placed into runoff in 1999.

Ceded

An assumption treaty ceding California assigned risk policies to American International Insurance Company was enacted on March 1, 2002.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 650,698	\$	\$ 650,698	
Mortgage loans on real estate:				
First liens	1,592,316		1,592,316	
Real estate:				
Properties held for the production of income	3,555,741		3,555,741	
Properties held for sale	388,190		388,190	
Cash and short-term investments	2,001,153		2,001,153	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	(5,955)		(5,955)	
Funds held by or deposited with reinsured companies	333,256		333,256	
Current federal and foreign income tax recoverable and interest thereon	155,096		155,096	
Net deferred tax asset	199,669	150,178	49,491	
Interest, dividends, and real estate income due and accrued	50,330		50,330	
Furniture, equipment and software	5,608	5,608		
Other assets nonadmitted	13,623	13,623		
Aggregate write-ins for other than invested assets	<u>18,254</u>	<u>1,753</u>	<u>16,501</u>	
Total assets	<u>\$ 8,957,979</u>	<u>\$ 171,162</u>	<u>\$ 8,786,817</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 104,743	(1)
Loss adjustment expenses			20,652	(1)
Commissions payable, contingent commissions			321	
Other expenses			54,248	
Taxes, licenses, and fees			(3,594)	
Unearned premiums			<u>24,897</u>	
Total liabilities			201,267	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		1,950,463		
Unassigned funds (surplus)		<u>4,035,087</u>		
Surplus as regards policyholders			<u>8,585,550</u>	
Total liabilities, surplus and other funds			<u>\$ 8,786,817</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 324,398
Deductions:		
Losses incurred	\$ 53,386	
Loss expense incurred	100,766	
Other underwriting expenses incurred	481,726	
		<hr/>
Total underwriting deductions		635,878
		<hr/>
Net underwriting loss		(311,480)

Investment Income

Net investment income earned	\$ 726,787	
Net realized capital gains	27,580	
		<hr/>
Net investment gain		754,367

Other Income

Miscellaneous income	\$ 37,664	
		<hr/>
Total other income		37,664
		<hr/>
Net income before federal income taxes		480,551
Federal income taxes incurred		(186,422)
		<hr/>
Net income		\$ 666,973
		<hr/>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 8,347,055
Net income	\$ 666,973	
Net unrealized capital losses	(2,120)	
Change in net deferred income tax	(276,717)	
Change in nonadmitted assets	250,359	
Dividends to stockholders	(400,000)	
		<hr/>
Change in surplus as regards policyholders		238,495
		<hr/>
Surplus as regards policyholders, December 31, 2004		\$ 8,585,550
		<hr/>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination	\$ 9,406,111
---	--------------

	Gain in Surplus	Loss in Surplus
Net loss	\$	\$ 704,293
Net unrealized capital gains	277,482	
Change in net deferred income tax		296,331
Change in nonadmitted assets		18,419
Cumulative effect of changes in accounting principles	321,000	
Dividends to stockholders		400,000
Totals	\$ 598,482	\$ 1,419,043

Net decrease in surplus as regards policyholders	<u>(820,561)</u>
--	------------------

Surplus as regards policyholders, December 31, 2004, per Examination	<u>\$ 8,585,550</u>
---	---------------------

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on the review made by a California Department of Insurance Casualty Actuary, the Company's December 31, 2004 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None

Previous Report of Examination

Corporate Records (Page 5): It was recommended that the Company submit all Holding Company Act filings as required by California Insurance Code (CIC) Section 1215.4. The Company is now in compliance.

Reinsurance - Ceded (Page 7): It was recommended that the Company amend its reinsurance agreement upon renewal and initiate all future agreements in compliance with CIC Section 922.2 and with CDI guidelines for offset clauses. The Company is now in compliance.

Accounts and Records - Information System Controls (Page 9): It was recommended that the Company review its information systems and make appropriate changes to strengthen internal controls. The Company has implemented this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_____
Aram W. Shahenian, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California